

# THE BOND BUYER

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## NFMA Panel: Insurers Won't Go Extinct

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By [Dakin Campbell](#)

MIAMI BEACH, Fla. - The utility of bond insurance for the municipal market will continue to exist long after the current crisis subsides, according to panelists at the annual conference of the National Federation of Municipal Analysts.

"We don't believe the business model is broken," said Standard & Poor's managing director Dick Smith. "If you have the stable rating and the capital, the market is still using you."

As bond insurers have seen their ratings threatened, and in many cases downgraded, in recent months due to subprime exposure eating up available capital, many market participants have questioned whether the industry will survive. Confidence in all but the most stable financial guarantors has been eroded and the use of insurance overall has been halved.

And yet panelists at the final session of the NFMA conference remained optimistic about the insurers, as long as a number of considered actions are taken, they said. The path to stability should involve well-thought-out solutions.

"Intelligent debate is critical to finding a way out of the morass," said John Hallacy, managing director at Merrill Lynch & Co., who moderated the panel. Terry Trim, senior research analyst at Nuveen Investments, said the current problems reflect a crisis of confidence in the insurance companies and their ratings.

"What it comes down to is if there is confidence in the triple-A rating," Trim said.

One of the confidence killers is a lack of knowledge about the ratings process, according to Trim. In comparison to ratings on companies, states, or school districts, the bond insurance rating reflects the dynamics of trading and liquidity in a broader market, he said.

And until market participants and equity investors can understand the ratings process and where the bond insurers fit into it, many misconceptions will persist. This can be countered with better communication and more comprehensive disclosure, Trim said.

That is not to say that the bond insurers should be exonerated, the panelists said. Many continued to write structured finance business throughout 2007 even after concerns about subprime mortgages surfaced in late 2006, Standard & Poor's Smith noted. In many cases, risk procedures need to be updated to prevent something similar in the future, he said.

He added that Standard & Poor's met with reluctance when it told bond insurers last fall that they

needed to get ahead of the curve and raise capital before they were forced.

Many market participants have said that Ambac Financial Group's former chief executive officer, Robert Genader, was strongly opposed to a capital raise.

And though Ambac and MBIA Inc. were ultimately successful in raising needed capital, the terms were onerous, calling into question the ability to access the markets in the future, Smith said.

The rating agency was also disappointed with the behavior of some of the bond insurers' owners, who did not contribute needed capital to their financial guaranty companies when they should have, Smith said.

"We are a little disappointed with owners who we would have thought to be supportive of their companies but for some reason or another, chose to go in another direction," he said. "We will probably take less comfort from owners that claim to be strategic owners going forward."

Regardless of the pitfalls that got the market into its current state, there do appear to be some solutions.

A sector of investors is looking to put money into a municipal-market or project-finance type of company, which could include buying exposure to the muni books of the bond insurers, according to Smith.

And reinsurance continues to be a viable option, though the bond insurers have not employed it as much as many thought they would which shows the limitation of reinsurance as a viable solution.

"I presume the reduced use of reinsurance is a lack of capacity or increased prices," said Elizabeth Hill, managing director at Financial Security Assurance Inc. and chairwoman of the risk management committee for the Association of Financial Guaranty Insurers.

But above all, hibernation looks to be the best solution, Smith said. By ceasing to write new business, the bond insurers can free up capital pledged to cover losses by letting policies run down. In the first quarter, Ambac freed up about \$390 million through this strategy.

This is only a short-term solution and it is still too early to demand the longer-term equivalent known as runoff because the market has not yet stabilized, Smith said.

"The most effective strategy we have seen is going into hibernation," he said. "The flip side is you can't do it inevitably. You lose some franchise value and longterm it has significant risk."

In the meantime, the market should wait to see a couple of earnings quarters where the bond insurers' losses show stabilization.

"We're looking for an area of more normalcy," Trim said. "A couple of quarters of earnings would go a long way to restoring ratings."

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